4 of the Most Important School Loan Questions (And Their Answers)

A chartered financial analyst breaks down the basics on dental debt

by Travis Hornsby, CFA

Travis Hornsby is the founder of Student Loan Planner, a consulting company dedicated to helping dentists increase the return on investment for their education. Before advising clients on student loans, Hornsby was a bond trader for one of the world's biggest investment firms. (He thanks his fiancée for getting him involved in the student loan world after revealing the extent of her medical school debt.) He lives in St. Louis.
Contact: travis@studentloanplanner.com

You've graduated dental school and you're stoked. Six-figure income, you're champing at the bit to learn clinical skills, and you're looking at buying a practice in the next few years.

One problem, though: Your dental school's financial aid office may have told you a few things about income-based repayment and the importance of budgeting at exit counseling, but now it's *real*. You look at your first loan statement, and you realize you owe $350,000 for your degree.

I've advised $47 million in dental school loans for new grads over the past year, and along the way I've answered many questions. Of all the ones I field, these are the top four—and the answers that usually apply.

1 Should I refinance my loans, and when should I pull the trigger?

Maybe you've heard about companies that want to lend you money at a lower interest rate than the 6 percent to 8 percent that federal loans charge. Here's a good rule of thumb: If you're expecting to owe less than two times your household income within five years of graduation, you'll probably want to refinance.

Say, for example, that you're making $130,000 in your first year out, and you have $300,000 in Stafford and PLUS loans at a 7 percent rate. To get a 10-year refinancing deal, you're going to have to pay more than $3,000 a month. That's a tough pill to swallow without knowing what your expenses look like.

For that reason, most new dentists will be well served by using the Revised Pay As You Earn (REPAYE) program in their first year. In most cases, you can use it to get an interest subsidy.

Once the government finds out that you make a decent income in your second year, you'll want to consider refinancing companies' offers.

Make sure you check at least three different lenders and shop around for the best rates.

2 How should I be making payments if I'm an associate?

If you graduated with less than $350,000 in dental school loans, I recommend that you get aggressive with repayment right away. Either refinance, or get on the REPAYE program and pay extra toward the loans with the highest interest rates.

If you owe more than that, then you really need to look at the math behind loan forgiveness. You can use the government's income-driven repayment plans to pay a percentage of your income each year. At the end of 20–25 years, depending on the plan you choose, you'll have the balance forgiven.

However, there's a catch: You'll have that balance added to your income in the year of forgiveness, and you'll owe taxes on that balance.

If you make a bunch of money as a practice owner, then using income-driven repayment long term will just cost you a lot of extra interest payments. If you're making a modest income long term, then you need to choose between the REPAYE program and the Pay As You Earn (PAYE) program, which caps your monthly federal student loan payments at 10 percent of your discretionary income.

Max out your retirement accounts, save $200–$500 every month for the tax bomb you'll be hit with at the end of the 20–25 years … and cross your fingers that they don't repeal those programs before you're done.

3 How do I handle my student debt if I want to buy a practice?

A lot of new grads tell me they just got off the phone with a bank that told them they'll need all the gold in Fort Knox in their checking account before they can get a practice loan.

I'm joking, of course, but how do you think about paying down student loans when you want to buy a practice ASAP and need a bunch of savings to do it?

In general, after a productive year as an associate you should be able to get a practice loan with 3 percent of the practice purchase price in the bank. That means if you want to buy a $600,000 practice, you need $18,000 in the bank.

Don't worry about having way more than that. If you want to own a practice, use that 3 percent equation and divide the amount by the number of months you'll need to save until you can become your own boss. Set aside that amount every month, and then pay as much of what you can from what's left to reduce the balance of your student loans.

4 How will my dental student debt affect my spouse?

Most dentists use either the IBR, REPAYE or PAYE plans to pay on their loans during their first year. Those plans are based on your *household*, not individual, income and student debt.

My rule of thumb for going for refinancing instead of forgiveness is having a debt-to-income ratio below 2:1 within five years of graduation. Factor your spouse's income into that equation.

Example: You've got $450,000 in dental school debt and plan on eventually earning $200,000 a year as a practice owner. If you were single, you might sign up for PAYE and put away money to pay the taxes that would be due in 20 years when the rest of the balance is forgiven.

However, if you had a spouse who makes $120,000 a year in corporate America and has no student debt, your future debt-to-income ratio would drop below 2:1. (The debt would still be $450,000, but your household income is now $320,00, for a ratio of 1.4:1.) That's a clear refinancing situation.

If both of you have similar earnings trajectories and debts, then being married doesn't affect your loans much. If one has a small debt load and the other has a large debt load, plan as a couple, not two separate individuals. If you don't, you'll just cost yourselves money.

You might have heard that you can file taxes separately to keep your payments down. While that's true, usually the extra tax costs from filing separately outweigh the lower payments.

Once you're married, student loans affect your spouse no matter what you do. Don't feel guilty! Make a budget together, and craft a plan you both feel good about.

Planning makes all the difference

Whatever you do, don't bury your head in the sand and pretend the dental school debt isn't there. By attacking it head-on with a solid plan, you'll make the most of your educational investment and set yourself up for financial freedom. ■

Ask the author a question on our message boards!

Travis Hornsby, the founder of Student Loan Planner, posts regularly in the "Financing School and Loan Repayment" forum, one of several that Dentaltown hosts for dental students. To access them or to ask Hornsby a question, head to **dentaltown.com** and click "Message Boards," then "Dental Students and Residents."